



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224  
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR BRADFORD A. JOHNSON  
ASSOCIATE AREA COUNSEL, AREA 1 LM:FSH:HAR

Attn: Carmino Santaniello

FROM: Jasper L. Cummings  
Associate Chief Counsel CC:CORP

SUBJECT:

This Field Service Advice responds to your memorandum dated October 23, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

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**LEGEND**

Corporation A =

Corporation B =

Shareholder C =

Shareholder D =

Shareholder E =

Shareholder F =

Shareholder G =

Year 1 =

Year 2 =

Year 3 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

T =

U =

V =

W =

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X =

Business =

Property 1 =

Property 2 =

Agency =

State M =

a =

b =

c =

### **ISSUES**

(1) Whether a series of transactions involving Corporation A, Corporation B, and their common shareholders may be characterized as a reorganization under section 368(a)(1)(D) of the Internal Revenue Code ("Code").

(2) Alternatively, whether the transactions may be characterized as a reorganization under section 368(a)(1)(F) of the Code.

### **CONCLUSIONS**

(1) The Service may characterize the series of transactions involving Corporation A, Corporation B, and their common shareholders as a reorganization under section 368(a)(1)(D).

(2) The Service may not characterize the transactions as a reorganization under section 368(a)(1)(F).

### **FACTS**

The facts as we understand them are as follows:

Corporation A, an S corporation formed in Year 1, was engaged in Business until its dissolution in Year 3. Prior to Date 1, Shareholder C owned all the stock of Corporation A. On Date 1, Shareholder C transferred by gift a% of the Corporation A stock to his children, Shareholder D, Shareholder E, Shareholder F, and Shareholder G (collectively, the "Children"). After Date 1, each of the Children held c% of the Corporation A stock. On Date 4, Shareholder C sold his entire remaining

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interest in Corporation A to the Children for \$T (the “Stock Purchase”).<sup>1</sup> Shareholder C recognized capital gain as a result of the Stock Purchase. After the Stock Purchase, the Children held equal shares of Corporation A.

Corporation B, an S corporation formed in Year 1, is also engaged in Business. Prior to Date 2, Shareholder C owned all the stock of Corporation B. On Date 2, Shareholder C transferred by gift a% of the Corporation B stock to the Children. After Date 2, Shareholder C held b% of the Corporation B stock, and each of the Children held c% of the Corporation B stock.

In Year 2, Corporation A sold its largest asset to an unrelated third party for \$U. Part of the consideration was cash paid at the time of closing, and the remainder was an installment note for \$V (“Installment Note”). The purchaser satisfied the note on Date 6 by paying \$W, which included the note balance plus a prepayment penalty. The Children’s Schedule K-1s for Year 3 reflect each shareholder’s allocable share of the capital gain realized on the Installment Note.

During Year 3, Corporation A’s primary operating assets consisted of Property 1 and Property 2. On Date 3, Corporation A requested Agency’s permission to assign to Corporation B the licenses for Property 1 and Property 2. Agency granted permission for the assignment, and Corporation A assigned the assets to Corporation B for no consideration on Date 4.

On Date 5, Corporation A transferred its remaining operating assets to Corporation B for no consideration. After the transfer of its operating assets, Corporation A’s assets consisted solely of nonoperating assets, including the Installment Note and two other receivables.

At a special meeting of Corporation A’s shareholders on Date 4, the shareholders voted to dissolve Corporation A, effective on Date 7, and to distribute the remaining assets (the Installment Note and receivables) of Corporation A to the shareholders. Corporation A notified the State M Secretary of State of its intent to dissolve. Upon Corporation A’s dissolution, each of the Children received payments of \$X, which the taxpayers reported on the Schedule K-1s as liquidating distributions. Corporation A treated the values of neither the Property 1 and Property 2 licenses nor the assets transferred to Corporation B in the mass asset disposition as part of the liquidating distributions.

Corporation A and its shareholders treated the transactions described above as a complete liquidation of Corporation A. As a result of the Stock Purchase, each

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<sup>1</sup>The stock certificates for Shareholder C’s stock indicate that the Stock Purchase occurred on Date 5.

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of the Children had a basis in his Corporation A stock that exceeded the amount of the liquidating distribution. Each of the Children reported losses on the liquidation of Corporation A.

## **LAW AND ANALYSIS**

### **(1) The series of transactions involving Corporation A, Corporation B, and their common shareholders may be characterized as a reorganization under section 368(a)(1)(D).**

Several courts have characterized as reorganizations transactions that taxpayers have treated as liquidations. See, e.g., Rose v. United States, 640 F.2d 1030 (9th Cir. 1981); Atlas Tool Co. v. Commissioner, 614 F.2d 860 (3d Cir. 1980), cert. denied sub nom Shaffan v. Commissioner, 449 U.S. 836 (1980); Davant v. Commissioner, 366 F.2d 874 (5th Cir. 1966), cert. denied, 386 U.S. 1022 (1967); Moffatt v. Commissioner, 363 F.2d 262 (9th Cir. 1966).

Section 368(a)(1)(D) defines a reorganization under that section as

a transfer by a corporation of all or part of its assets to another corporation if immediately after the transfer the transferor, or one of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356.

For nondivisive reorganizations under section 368(a)(1)(D), “control” means ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation. The attribution rules of section 318 apply to the control determination. Sections 304(c), 318, 368(a)(2)(H). Here, Corporation A and Corporation B have identical ownership before and after the transactions by virtue of the section 318 attribution rules. Shareholder C and the Children collectively own all the stock of both Corporation A and Corporation B, thus satisfying the control requirement of section 368(a)(2)(H).

Section 354(a) provides that a shareholder recognizes no gain or loss on the exchange, in pursuance of the plan of reorganization, of his stock or securities in a corporation that is party to a reorganization solely for stock or securities in such corporation or in another corporation party to the reorganization. Section 354(b)(1) provides that section 354(a) will not apply to an exchange in pursuance of a plan of reorganization within the meaning of section 368(a)(1)(D) unless the corporation to

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which the assets are transferred acquires substantially all the assets of the transferor corporation, and the stock, securities, and other properties received by the transferor are distributed in pursuance of the plan of reorganization.

Although the taxpayers in the present case characterized the transaction as a liquidation, their label is not determinative. Courts have not required a formal written plan of reorganization if other evidence establishes the existence of a plan of reorganization. See Atlas Tool, 614 F.2d at 866 (“If what resulted was a reorganization, the chosen label is not dispositive.”). Here the proximity of time between the shareholders’ agreement to dissolve Corporation A and the asset transfers for no consideration to commonly controlled Corporation B establish the plan. Corporation A’s transfer of all of its operating assets to Corporation B, followed by Corporation A’s dissolution, indicates a mere readjustment of continuing interests in property, the hallmark of a reorganization.

Courts generally have interpreted the “substantially all the assets” requirement for D reorganizations to mean operating assets, rather than total assets. See, e.g., Smothers v. United States, 642 F.2d 894 (5th Cir. 1981); American Mfg. Co. v. Commissioner, 55 T.C. 204 (1970); James Armour Inc. v. Commissioner, 43 T.C. 295 (1965).. Here, Corporation A satisfied the substantially all requirement by transferring all of its operating assets to Corporation B for no consideration.

Although section 368(a)(1)(D) requires a distribution of stock or securities, courts generally have not interpreted this provision literally. Courts and the Service have held that a distribution of stock or securities is not necessary where there is common ownership of the transferor and transferee corporation. See Rose, 640 F.2d at 1034; Atlas Tool, 614 F.2d at 865; Davant, 366 F.2d at 886-887. See also Rev. Rul 70-240, 1970-1 C.B. 81.

In addition to meeting the statutory requirements, a transaction must satisfy certain nonstatutory requirements to qualify as a reorganization under section 368(a)(1)(D), including the continuity of business enterprise requirement. The continuity of business enterprise requirement is satisfied in this case. Following Corporation A’s transfer of its historic business assets to Corporation B, Corporation B conducted the historic business with those assets in substantially the same manner in which it had been conducted prior to the transfer. See § 1.368-1(d).

We believe it is appropriate to recharacterize the series of transactions involving Corporation A, Corporation B, and their common as a reorganization under section 368(a)(1)(D).

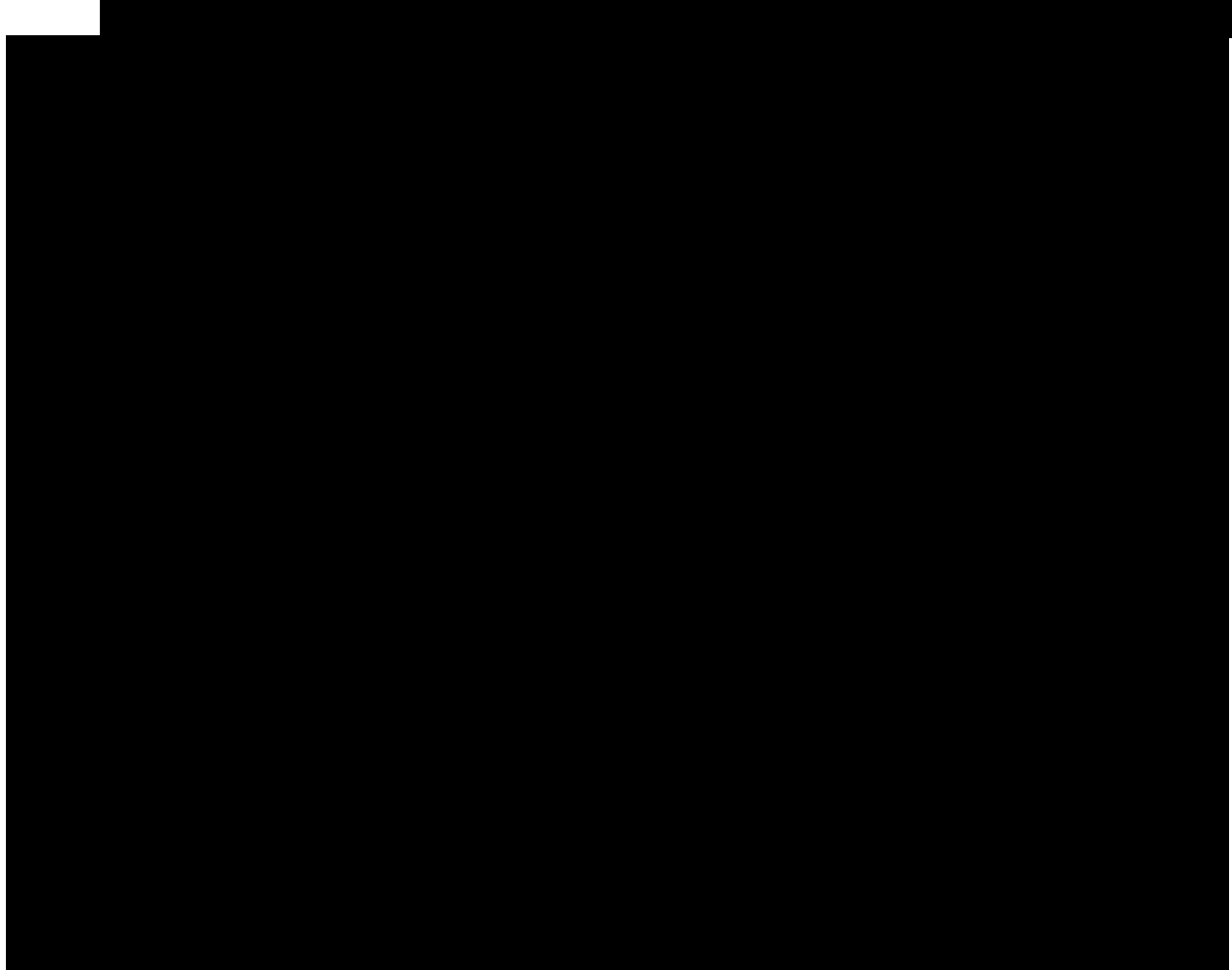
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**(2) The transactions may not be characterized as a reorganization under section 368(a)(1)(F).**

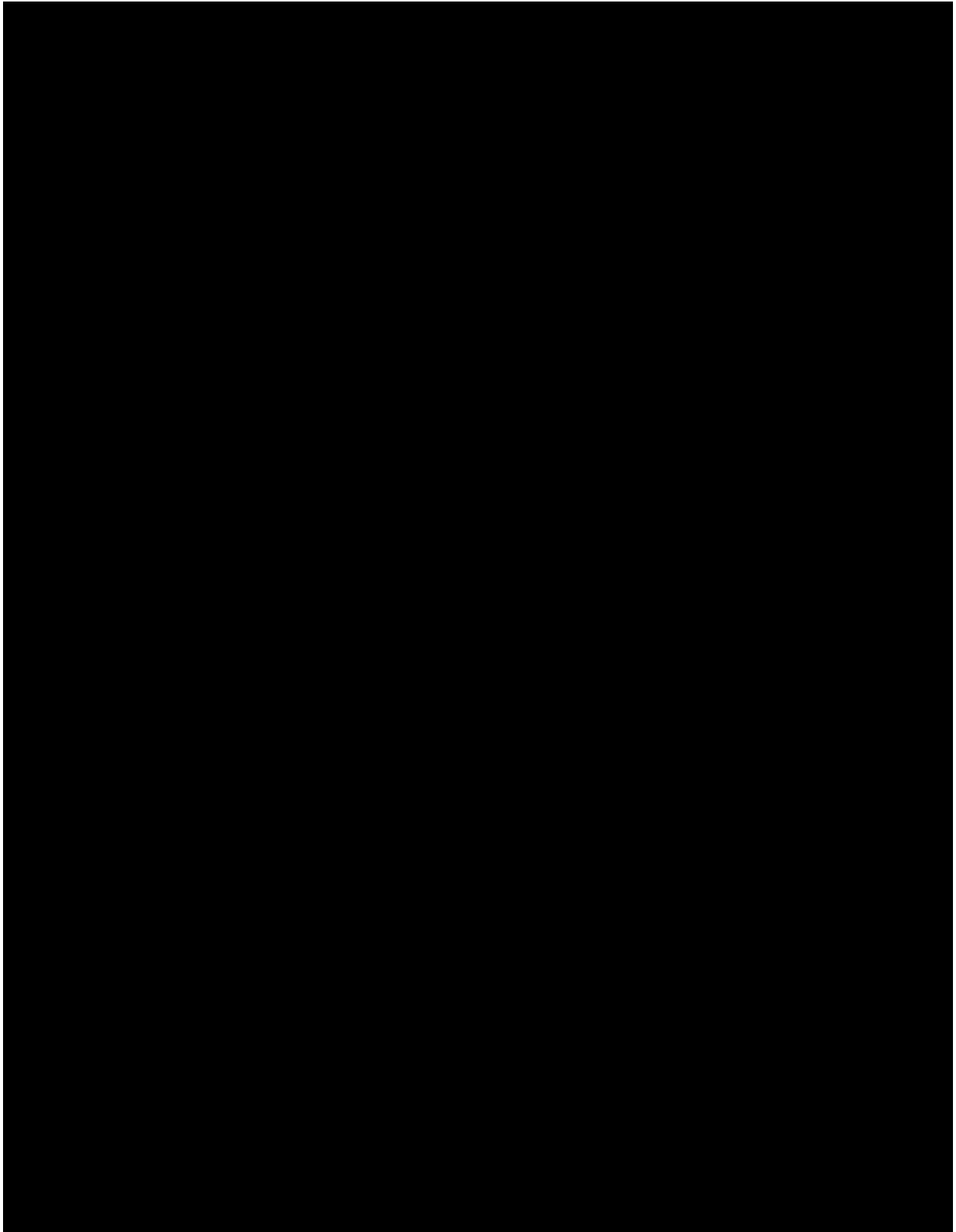
A section 368(a)(1)(F) reorganization is a “mere change in identity, form, or place of organization of one corporation, however effected.” The statutory provision indicates that only a single corporation can engage in a reorganization under section 368 (a)(1)(F).

The legislative history of section 368(a)(1)(F) suggests that Congress intended to permit a reorganization by multiple entities under this subsection only if the purported reorganization involves a single operating company. See Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 225(a), 96 Stat. 324, 490. In the present case, both Corporation A and Corporation B were operating companies prior to the transaction. Accordingly, the transactions cannot be characterized as a reorganization under section 368(a)(1)(F).

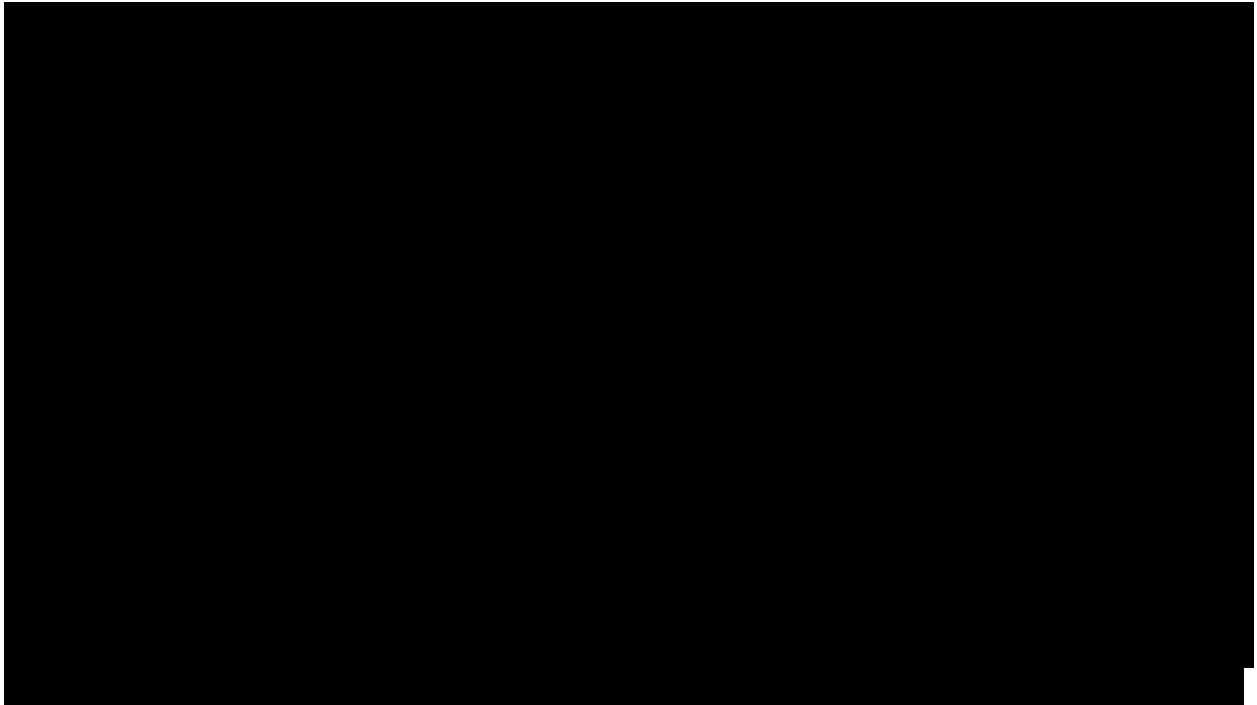
**CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS**



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Please call Marie Byrne at (202) 622-6831 if you have any further questions.

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By: \_\_\_\_\_  
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